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February 14, 2001

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Magalie Roman Salas  
Secretary  
Federal Communications Commission  
445 12th Street, SW  
Washington, DC 20554

Re: Ex Parte Communication  
CC Docket No. 96-98 / UNE Remand Proceeding)

Dear Ms. Salas:

As the Commission is aware, the Promoting Active Competition Everywhere ("PACE") Coalition was expressly formed to promote widespread competition for residential and small business customers. Members of the Coalition have invested more than \$1.5 billion developing a diverse base of communications facilities, operational infrastructure and innovative software to compete in the local telecom market. The common thread among these companies, however, is their use of unbundled local switching ("ULS") to establish the broad market footprint required by their business strategies, and to offer conventional voice services to customers not yet positioned to benefit from more advanced digital services.

Market experience has repeatedly demonstrated that achieving broad competition for the typical residential and small business customer requires access to a full complement of unbundled network elements, including local switching. Despite the compelling weight of this evidence, however, Allegiance Telecom, Inc. selectively advocates that access to unbundled local switching should be restricted. Specifically, Allegiance now recommends that the

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Commission deny entrants access to unbundled local switching in any MSA where four CLECs have deployed switches, except to serve residential customers.<sup>1</sup>

It is useful to note that the Allegiance Letter, despite its length, offers no new evidence addressing the issues in the proceeding. At most, the letter simply reveals that Allegiance is willing to support an entry barrier that frustrates competition, so long as such barrier does not directly impact Allegiance itself.<sup>2</sup> Nevertheless, the PACE Coalition is compelled to respond to its suggestion because its proposal would seriously harm local competition, particularly for those customers that the PACE Coalition was formed to assist.

There is no evidence that UNE-P based entry is adversely affecting Allegiance in any market where it has been made available. To the contrary, analysts report that Allegiance "... is generating EBITDA margins north of 30% in its older markets (highly competitive markets such as New York, Dallas and Atlanta)."<sup>3</sup> These markets are two (if not three) of the most active UNE-P markets in the nation. Nevertheless, in contradiction of its own earlier recommendations

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<sup>1</sup> See Letter from Thomas Jones to Magalie Roman Salas, Secretary, Federal Communications Commission, CC Docket 96-98, January 30, 2001 (Allegiance Letter).

<sup>2</sup> A more complete review of Allegiance's filings in this proceeding reveals that its position with respect to local switching diverge sharply from the impairment analysis it would otherwise recommend. Earlier in this docket, Allegiance cautioned against favoring one entry strategy over another:

The fact that a single competitive LEC is able to provide a service by self-provisioning a network element does not establish that a competitive wholesale market exists for that element. More generally, the fact that some competitive LECs choose to offer service by self-provisioning does not mean either that other competitive LECs are required to follow the same entry strategy or that other entry strategies are inefficient.

Reply Comments of Allegiance Telecom, Inc., CC Docket No. 96-98, June 10, 1999, page 9. Allegiance recommended then that the Commission require the ILECs to offer (without limitation) every network element specifically listed in the Section 271 Competitive Checklist, a recommendation that would have included local switching.

<sup>3</sup> Source: Hibernia Southcoast Capital, December 6, 2000. Other analysts have estimated that Allegiance's margins in its older markets are "well north" of 30%: "...the company's older markets already are EBITDA positive and are achieving approximately 60% gross margins." *Buckingham: ALGX- Strong Buy - Initiating Coverage*, Buckingham Research Group, January 10, 2001.

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in this proceeding, and despite its inability to demonstrate any competitive impact, Allegiance has chosen to support ILEC efforts to restrict competition. Specifically, Allegiance recommends that access to unbundled local switching be restricted from serving *any* business customer *anywhere* in an MSA where there are four CLEC switches. Allegiance does not propose an *explicit* restriction that would limit the availability of unbundled local switching to serve residential customers (although its proposal would harm residential competition nonetheless). For a number of reasons, the Commission should reject the Allegiance proposal.

First, the mere presence of a CLEC switch does nothing to indicate the types of services and/or customers that are being served by the switch. As the PACE Coalition has demonstrated – and submissions from a number of CLECs confirm -- CLEC switches generally support only digital services,<sup>4</sup> or focus extensively on particular customers with unidirectional calling patterns.<sup>5</sup> Indeed, some CLEC switches may not provide conventional voice services at all, but are instead deployed as part of innovative Internet routing and aggregation configurations.<sup>6</sup>

Second, the Allegiance proposal implicitly asserts that *four* CLEC switches is the appropriate degree of competitive entry without any explanation as to why such a standard is reasonable. Would Allegiance similarly support removal of the ILEC's *loop* unbundling obligation once four alternatives (for instance, three wireless and one cable provider) offer

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<sup>4</sup> For instance, Focal Communications Corporation ("Focal") has informed the Commission that it "...concentrates exclusively on customers that have a current need for DS1 communications functionality or higher." Letter from Richard Metzger and Patrick Donovan to Magalie Roman Salas, Secretary, Federal Communications Commission, CC Docket No. 96-98, May 19, 2000, page 2. See also Letter from Chuck Goldfarb to Magalie Roman Salas, Secretary, Federal Communications Commission, CC Docket No. 96-98, June 21, 2000, page 3 ("WorldCom cannot provide analog trunk service to the end user without assuming the cost of placing in its collocation spaces expensive customer terminating equipment used to convert digital signals to analog signals"), and letters from Genevieve Morelli to Magalie Roman Salas, Secretary, Federal Communications Commission, CC Docket No. 96-98, July 17, 2000 and January 8, 2001.

<sup>5</sup> Letter from Genevieve Morelli to Magalie Roman Salas, Secretary, Federal Communications Commission, CC Docket No. 96-98, August 24, 2000, Attachment 1.

<sup>6</sup> In a variant of its proposal, Allegiance suggests that the Commission further condition the elimination of local switching as a network element upon a finding that 50% of the serving wire centers in an MSA have established a collocated CLEC. This aspect of its proposal, however, suffers the same deficiency as its "four switch" criteria – there is simply no basis to assume that a collocation facility is being used to offer voice services to smaller business customers, particularly in the current environment where a large number of collocation arrangements have been established to offer xDSL-based service. Further, many collocation arrangements remain vacant, as financing problems curtail carrier plans.

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service in an MSA? Moreover, there is no basis for the Commission to prejudge the correct level of competitive entry, for that is a judgment better left to markets themselves.

Third, the Allegiance proposal ignores (and may in fact cause) the unfortunate trend of CLEC bankruptcy and consolidation that is presently under way. Despite the likelihood of consolidation, the Allegiance proposal never explains how future consolidations should be addressed. For instance, would the Allegiance proposal reinstate the unbundling obligation for switching if a single carrier acquired all four switches? Or would the proposal sanction the resulting oligopoly?

Fourth, the Allegiance proposal in effect asserts (again without evidence) that *any* business customer in an MSA could be served as long as a CLEC switch is located *somewhere* in the MSA. As the PACE Coalition has shown, however, the cost of an EEL substantially raises the customer size needed to extend service to a distant location,<sup>7</sup> and there is no indication that carriers are requesting (much less obtaining) analog EELs to serve smaller locations. Nevertheless, Allegiance would willingly deny customers throughout an MSA competitive services, simply because a few CLECs may have entered a central business district.

In addition to these flaws, the Allegiance approach would also isolate residential customers from the benefits of local competition. Although Allegiance may claim that unbundled local switching would still be available to serve residential customers, its proposal ignores the critical synergies achievable only when an entrant can serve the *full* analog market, a market that includes both residential and smaller business customers. The operational infrastructure needed to support UNE-P entry is substantial. It is critical that this infrastructure can be shared in both the residential and business markets for entry to be made viable in each.

Although some carriers may enter by focusing initially on only one customer group, it is clear that the natural dynamic favors extending service to both groups. For instance, PACE Coalition member Z-Tel began by focusing exclusively on residential customers, but now intends to bring its innovative services to small businesses. Conversely, Birch introduced its services first to the business market, but is now examining entering the residential market. While Allegiance may assert that its proposal would still foster residential competition, the facts do not support the claim.<sup>8</sup> There is no evidence to suggest that competition can be *isolated* to the residential market in the manner Allegiance recommends, any more than the ILECs would be

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<sup>7</sup> Letter from Genevieve Morelli to Magalie Roman Salas, Secretary, Federal Communications Commission, CC Docket No. 96-98, June 8, 2000.

<sup>8</sup> It is useful to note that Allegiance is not willing to test its thesis by offering residential service itself.

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able to offer *only* residential service without the ability to also serve comparable business customers.<sup>9</sup>

Finally, the PACE Coalition again emphasizes the importance of the Commission allowing the market to judge both the appropriate sequence and level of competitive investment. As noted at the outset, PACE Coalition members have invested heavily in the ability to offer competitive local services – sometimes in the form of local switches, but also in the form of xDSL equipment, innovative software, and efficient back-office systems to provide quality customer support. As Allegiance is well aware, one of the most significant impediments to competitive success is the difficulty of establishing the critical OSS systems needed to efficiently provision and bill services for those customers won by the entrant.<sup>10</sup> One important benefit of unbundled local switching is that it enables entrants to first establish this important dimension, as well as create the necessary marketing and sales channels needed to succeed.

In short, the Allegiance proposal is self-serving and callous.<sup>11</sup> It would arbitrarily impose limitations on the one network element (local switching) to which Allegiance has no immediate need, while foreclosing other carriers from introducing innovative business plans that may differ from that of Allegiance. It would deny smaller businesses throughout an MSA the benefits of

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<sup>9</sup> Indeed, some ILECs claim that residential service is subsidized by their business service. While the PACE Coalition believes that this assertion may be an overstatement, there can be no doubt that the attractiveness of the residential market to the ILEC is partially the result of the scope economies it enjoys by virtue of its serving both markets using the same network, facilities, and infrastructure. Allegiance never explains – nor could it – how CLECs would be able to compete effectively against an ILEC if denied these same synergies.

<sup>10</sup> Ironically, Allegiance proudly touts its approach as the “Smart Build.” Despite its criticism of UNE-based competition, Allegiance does *not* enter the market by deploying a competitive network, but rather leases its network facilities (other than switching) from other carriers and uses its capital to develop its back-office expertise. Using Allegiance’s term, the PACE Coalition members pursue a “Smarter Build” strategy – we recognize that competitive success can only come to those that differentiate, but we recognize as well that local circuit switching is not the only (or even the best) way to differentiate oneself in the market.

<sup>11</sup> It is useful to note that Allegiances proposal has gained support from Time-Warner Telecom. Letter from Don Shephard to Magalie Roman Salas, Secretary, Federal Communications Commission, CC Docket No. 96-98, February 6, 2001. While Allegiance has apparently chosen to avoid the residential market (and is therefore unaffected by the impact of its proposal on those customers), Time Warner is actually prohibited from serving residential customers until 2003. See letter from Genevieve Morelli to Magalie Roman Salas, Secretary, Federal Communications Commission, CC Docket No. 96-98, January 8, 2001.

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competition, simply because some larger customers may have choice in a central business district. It would sanction an oligopoly of initial entrants, without regard to a broader need to lower entry barriers for subsequent innovators. And it would create yet another pervasive barrier to residential competition by denying CLECs the ability to leverage their entry costs in both the residential and business markets. The Commission should reject the Allegiance proposal.

Sincerely,

A handwritten signature in black ink that reads "Genevieve Morelli". The signature is fluid and cursive, with a large initial "G".

Genevieve Morelli

cc: Chairman Michael Powell  
Commissioner Susan Ness  
Commissioner Harold Furchtgott-Roth  
Commissioner Gloria Tristani  
Dorothy Attwood  
Glenn Reynolds  
Michelle Carey  
Jordan Goldstein  
Kyle Dixon  
Deana Shetler  
Rebecca Beynon  
Jonathan Reel